I

Individual Psychology

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4. WHY TRADE?

Trading appears deceptively easy. When a beginner wins, he feels brilliant and invincible. Then he takes wild risks and loses everything.

People trade for many reasons—some rational and many irrational. Trading offers an opportunity to make a lot of money in a hurry. Money symbolizes freedom to many people, even though they often do not know what to do with their freedom.

If you know how to trade, you can make your own hours, live and work wherever you please, and never answer to a boss. Trading is a fascinating intellectual pursuit: chess, poker, and a crossword rolled in one. Trading attracts people who love puzzles and brainteasers.

Trading attracts risk-takers and repels those who avoid risk. An average person gets up in the morning, goes to work, has a lunch break, returns home, has a beer and dinner, watches TV, and goes to sleep. If he makes a few extra dollars, he puts them into a savings account. A trader keeps odd hours and puts his capital at risk. Many traders are loners who abandon the certainty of the present and take a leap into the unknown.

Self-Fulfillment

Most people have an innate drive to achieve their personal best, to develop their abilities to the fullest. This drive, along with the pleasure of the game and the lure of money, propels traders to challenge the markets.

Good traders tend to be hardworking and shrewd men. They are open to new ideas. The goal of a good trader, paradoxically, is not to make money. His goal is to trade well. If he trades right, money follows almost as an afterthought. Successful traders keep honing their skills. Trying to reach their personal best is more important to them than making money.

A successful New York trader said to me: "If I become half a percent smarter each year, I'll be a genius by the time I die." His drive to improve himself is the hallmark of a successful trader.

A professional trader from Texas invited me to his office and said: "If you sit across the table from me while I day-trade, you won't be able to tell whether I am $2000 ahead or $2000 behind on that day." He has risen to a level where winning does not elate him and losing does not deflate him. He is so focused on trading right and improving his skills that money no longer influences his emotions.

The trouble with self-fulfillment is that many people have a self-destructive streak. Accident-prone drivers keep destroying their cars, and self-destructive traders keep destroying their accounts (see Section 7). Markets offer unlimited opportunities for self-sabotage, as well as for self-fulfillment. Acting out your internal conflicts in the marketplace is a very expensive proposition.

Traders who are not at peace with themselves often try to fulfill their contradictory wishes in the market. If you do not know where you are going, you will wind up somewhere you never wanted to be.

5. FANTASY VERSUS REALITY

If you hear from a friend with little farming experience that he plans to feed himself with food grown on a quarter-acre plot, you will expect him to go hungry. We all know that one can squeeze only so much blood from a turnip. The one field in which grown-ups let their fantasies soar is trading.

Just the other day, a friend told me that he expected to support himself trading his $6000 account. When I tried to show him the futility of his plan, he quickly changed our topic of conversation. He is a bright analyst, but he refuses to see that his "intensive farming" plan is suicidal. In his desperate effort to succeed, he must take on large positions—and the slightest wiggle of the market is sure to put him out of business.

A successful trader is a realist. He knows his abilities and limitations. He sees what is happening in the markets and knows how to react to

them. He analyzes the markets without cutting corners, observes his own reactions, and makes realistic plans. A professional trader cannot afford illusions.

Once an amateur takes a few hits and gets a few margin calls, he becomes fearful instead of cocky and starts developing strange ideas about the markets. Losers buy, sell, or miss trades thanks to their fantastic ideas. They act like children who are afraid to pass a cemetery or look under their bed at night because they are afraid of ghosts. The unstructured environment of the market makes it is easy to develop fantasies.

Most people who have grown up in Western civilization have several similar fantasies. They are so widespread that when I studied at the New York Psychoanalytic Institute, there was a course called “Universal Fantasies.” For example, most people have a fantasy in childhood that they were adopted rather than born to their parents. A fantasy seems to explain the unfriendly and impersonal world. It consoles a child but prevents him from seeing reality. Our fantasies influence our behavior, even if we are not consciously aware of them.

In talking to hundreds of traders, I keep hearing them express several universal fantasies. They distort reality and stand in the way of trading success. A successful trader must identify his fantasies and get rid of them.

The Brain Myth

Losers who suffer from the “brain myth” will tell you, “I lost because I didn’t know trading secrets.” Many losers have a fantasy that successful traders have some secret knowledge. This fantasy helps support a lively market in advisory services and ready-made trading systems.

A demoralized trader often whips out his checkbook and goes shopping for “trading secrets.” He may send money to a charlatan for a $3000 “can’t miss,” backtested, computerized trading system. When that self-destructs, he sends another check for a “scientific manual” that explains how he can stop being a loser and become a true insider and a winner by contemplating the Moon, Saturn, or even Uranus.

The losers do not know that trading is intellectually fairly simple. It is less demanding than taking out an appendix, building a bridge, or trying a case in court. Good traders are often shrewd, but few of them are intellectuals. Many have not been to college, and some have even dropped out of high school.

Intelligent and hardworking people who have succeeded in their careers often feel drawn to trading. The average client of a brokerage firm is 50 years old, is married, and has a college education. Many have postgraduate degrees or own their businesses. The two largest professional groups among traders are engineers and farmers.

Why do these intelligent and hardworking people fail in trading? What separates winners from losers is neither intelligence nor secrets, and certainly not education.

The Undercapitalization Myth

Many losers think that they would be successful if they could trade a bigger account. All losers get knocked out of the game by a string of losses or a single abysmally bad trade. Often, after the amateur is sold out, the market reverses and moves in the direction he expected. The loser is ready to kick either himself or his broker: Had he survived another week, he might have made a small fortune!

Losers take this reversal as a confirmation of their methods. They earn, save, or borrow enough money to open another small account. The story repeats: The loser gets wiped out, the market reverses and "proves" the loser right, but only too late—he has been sold out again. That's when the fantasy is born: "If only I had a bigger account, I could have stayed in the market a little longer and won."

Some losers raise money from relatives and friends by showing them a paper track record. It seems to prove that they would have won big, if only they had had more money to work with. But if they raise more money, they lose that, too—it is as if the market were laughing at them!

A loser is not undercapitalized—his mind is underdeveloped. A loser can destroy a big account almost as quickly as a small one. He overtrades, and his money management is sloppy. He takes risks that are too big, whatever the size of his account. No matter how good his system is, a streak of bad trades is sure to put him out of business.

Traders often ask me how much money they need to begin trading. They want to be able to withstand a drawdown, a temporary drop in the account equity. They expect to lose a large amount of money before making any! They sound like an engineer who plans to build several bridges that collapse before erecting his masterpiece. Would a surgeon plan on killing several patients while becoming an expert at taking out an appendix?

A trader who wants to survive and prosper must control his losses. You do that by risking only a tiny fraction of your equity on any single trade (see Chapter 10, "Risk Management"). Give yourself several years to learn how to trade. Do not start with an account bigger than $20,000, and do not lose more than 2 percent of your equity on any single trade. Learn from cheap mistakes in a small account.

Amateurs neither expect to lose nor are in any way prepared for it. The notion of being undercapitalized is a cop-out that helps them avoid two painful truths: their lack of trading discipline, and their lack of a realistic money management plan.

The one advantage of a large trading account is that the price of equipment and services represents a smaller percentage of your money. A manager of a million-dollar fund who spends $10,000 on computers and seminars is only 1 percent behind the game. The same expenditure would represent 50 percent of the equity of a trader with a $20,000 account.

The Autopilot Myth

Imagine that a stranger walks into your driveway and tries to sell you an automatic system for driving your car. Just pay a few hundred dollars for a computer chip, install it in your car, and stop wasting energy on driving, he says. You can take a nap in the driver's seat while the "Easy Swing System" whisks you to work. You would probably laugh the salesman out of your driveway. But would you laugh if he tried to sell you an automatic trading system?

Traders who believe in the autopilot myth think that the pursuit of wealth can be automated. Some try to develop an automatic trading system, while others buy one from the experts. Men who have spent years honing their skills as lawyers, doctors, or businessmen plunk down thousands of dollars for canned competence. They are driven by greed, laziness, and mathematical illiteracy.

Systems used to be written on sheets of paper, but now they usually come on copy-protected diskettes. Some are primitive; others are elaborate, with built-in optimization and money management rules. Many traders spend thousands of dollars searching for magic that will turn a few pages of computer code into an endless stream of money. People who pay for automatic trading systems are like medieval knights who paid alchemists for the secret of turning base metals into gold.

Complex human activities do not lend themselves to automation. Computerized learning systems have not replaced teachers, and programs for doing taxes have not created unemployment among accountants. Most human activities call for an exercise of judgment; machines and systems can help but not replace humans. So many system buyers have been burned that they have formed an organization, Club 3000, named after the price of many systems.

If you could buy a successful automatic trading system, you could move to Tahiti and spend the rest of your life in leisure, supported by a stream of checks from your broker. So far, the only people who have made money from trading systems are the system sellers. They form a small but colorful cottage industry. If their systems worked, why would they sell them? They could move to Tahiti themselves and cash checks from their brokers! Meanwhile, every system seller has a line. Some say they like programming better than trading. Others claim that they sell their systems only to raise trading capital.

Markets always change and defeat automatic trading systems. Yesterday's rigid rules work poorly today and will probably stop working tomorrow. A competent trader can adjust his methods when he detects trouble. An automatic system is less adaptable and self-destructs.

Airlines pay high salaries to pilots despite having autopilots. They do it because humans can handle unforeseen events. When a roof blows off an airliner over the Pacific or when a plane runs out of gas over the Canadian wilderness, only a human can handle such a crisis. These emergencies have been reported in the press, and in each of them experienced pilots managed to land their airliners by improvising. No autopilot can do that. Betting your money on an automatic system is like betting your life on an autopilot. The first unexpected event will destroy your account.

There are good trading systems out there, but they have to be monitored and adjusted using individual judgment. You have to stay on the ball—you cannot abdicate your responsibility for your success to a trading system.

Traders who have the autopilot fantasy try to repeat what they felt as infants. Their mothers used to fulfill their needs for food, warmth, and comfort. Now they try to re-create the experience of passively lying on their backs and having profits flow to them like an endless stream of free, warm milk.

The market is not your mother. It consists of tough men and women who look for ways to take money away from you instead of pouring milk into your mouth.

The Personality Cult

Most people give lip service to their wish for freedom and independence. When they come under pressure, they change their tune and start looking for "strong leadership." Traders in distress often seek directions from assorted gurus.

When I was growing up in the former Soviet Union, children were taught that Stalin was our great leader. Later we found out what a monster he had been, but while he was alive, most people enjoyed following the leader. He freed them from the need to think for themselves.

"Little Stalins" were installed in every area of society—in economics, biology, architecture, and so on. When I came to the United States and began to trade, I was amazed to see how many traders were looking for a guru—their "little Stalin" in the market. The fantasy that someone else can make you rich deserves its own discussion later in this chapter.

Trade with Your Eyes Open

Every winner needs to master three essential components of trading: a sound individual psychology, a logical trading system, and a good money management plan. These essentials are like three legs of a stool—remove one and the stool will fall, together with the person who sits on it. Losers try to build a stool with only one leg, or two at the most. They usually focus exclusively on trading systems.

Your trades must be based on clearly defined rules. You have to analyze your feelings as you trade, to make sure that your decisions are intellectually sound. You have to structure your money management so that no string of losses can kick you out of the game.

6. MARKET GURUS*

Gurus have been with us ever since the public entered markets. In 1841, the classic book on market manias, *Extraordinary Popular Delusions and the Madness of Crowds,* was published in England. It is still in print today. Its author, Charles Mackay, described the Dutch Tulip Mania, the South

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Seas Bubble in England, and other mass manias. Human nature changes slowly, and today new mass manias, including guru manias, continue to sweep the markets.

Guru manias spring up faster now than they did centuries ago, thanks to modern telecommunications. Even educated and intelligent investors and traders follow market gurus, like the devotees of the false Messiahs in the Middle Ages.

There are three types of gurus in the financial markets: market cycle gurus, magic method gurus, and dead gurus. Some gurus call important market turns. Others promote "unique methods"—new highways to riches. Still others have escaped criticism and invited cult following through the simple mechanism of departing this world.

Market Cycle Gurus

For many decades, the U.S. stock market has generally followed a four-year cycle. Significant bear market lows occurred in 1962, 1966, 1970, 1974, 1978, and 1982. The broad stock market has normally spent 2.5 or 3 years going up and 1 or 1.5 years going down.

A new market cycle guru emerges in almost every major stock market cycle, once every 4 years. A guru's fame tends to last for 2 to 3 years. The reigning period of each guru coincides with a major bull market in the United States.

A market cycle guru forecasts all major rallies and declines. Each correct forecast increases his fame and prompts even more people to buy or sell when he issues his next forecast. As more and more people take notice of the guru, his advice becomes a self-fulfilling prophecy. When you recognize a hot new guru, it pays to follow his advice.

There are thousands of analysts, some of whom are certain to be on a hot streak at any given time. Most analysts become hot at some point in their careers for the same reason a broken clock shows the right time twice a day. Those who have tasted the joy of being on a hot streak sometimes feel crushed when it ends and they wash out of the market. But there are enough old foxes who enjoy their occasional hot streaks, yet continue working as usual after their hot streak ends.

The success of a market cycle guru depends on more than short-term luck. He has a pet theory about the market. That theory—cycles, volume, Elliott Wave, whatever—is usually developed several years prior to

reaching stardom. At first, the market refuses to follow an aspiring guru's pet theory. Then the market changes and for several years comes in gear with theory. That is when the star of the market guru rises high and bright above the marketplace.

Compare this to what happens to fashion models as public tastes change. One year, blondes are popular, another year, redheads. Suddenly, last year's blonde star is no longer wanted for the front cover of a major women's magazine. Everybody wants a dark model, or a woman with a birthmark on her face. A model does not change—public tastes do.

Gurus always come from the fringes of market analysis. They are never establishment analysts. Institutional employees play it safe and never achieve spectacular results because each uses similar methods. A market cycle guru is an outsider with a unique theory.

A guru usually earns a living publishing a newsletter and can grow rich selling his advice. Subscriptions can soar from a few hundred annually to tens of thousands. A recent market cycle guru was reported to have hired three people just to open the envelopes with money pouring into his firm.

At investment conferences, a guru is surrounded by a mob of admirers. If you ever find yourself in such a crowd, notice that a guru is seldom asked questions about his theory. His admirers are content to drink in the sound of his voice. They brag to their friends about having met him.

A guru remains famous for as long as the market behaves according to his theory—usually for less than the duration of one 4-year market cycle. At some point the market changes and starts marching to a different tune. A guru continues to use old methods that worked spectacularly well in the past and rapidly loses his following. When the guru's forecasts stop working, public admiration turns to hatred. It is impossible for a discredited market cycle guru to return to stardom.

The reigning guru in the early 1970s was Edson Gould. He based his forecasts on policy changes of the Federal Reserve, as reflected in the discount rate. His famous rule of "three steps and a stumble" stated that if the Federal Reserve raised the discount rate three times, that showed tightening and led to a bear market. Lowering the discount rate in three steps revealed a loosening of the monetary policy and led to a bull market. Gould also developed an original charting technique called speedlines—shallow trendlines whose angles depended on the velocity of a trend and the depth of market reactions.

Gould became very hot during the bear market of 1973–1974. He vaulted to prominence after correctly calling the December 1974 bottom,

when the Dow Jones Industrials fell to near 500. The market rocketed higher, Gould presciently identified its important turning points using speedlines, and his fame grew. But soon the United States was flooded with liquidity, inflation intensified, and Gould's methods, developed in a different monetary environment, stopped working. By 1976, he had lost most of his following, and few people today even remember his name.

The new market cycle guru emerged in 1978. Joseph Granville stated that changes in stock market volume preceded changes in prices. He expressed it colorfully: "Volume is the steam that makes the choo-choo go." Granville developed his theory while working for a major Wall Street brokerage firm. He wrote in his autobiography that the idea came to him while sitting on a toilet contemplating the design of floor tiles. Granville took his idea from the bathroom to the chartroom, but the market refused to follow his forecasts. He went broke, got divorced, and slept on the floor of his friend's office. By the late 1970s, the market started to follow Granville's scripts as never before or since, and people began to take notice.

Granville toured the United States speaking to overflow crowds. He arrived on stage in a carriage, issued forecasts, and chided "bagholders" who would not recognize his theory. He played piano, sang, and, on occasion, even dropped his pants to make a point. His forecasts were spectacularly correct; he drew attention to himself and became widely quoted in the mass media. Granville became big enough to move the stock market. When he announced that he was bearish, the Dow dropped over 40 points in a day—a huge decline by the standards of that time. Granville became intoxicated with his success. The market surged higher in 1982, but he remained very bearish and kept advising his dwindling band of followers to continue to sell short. The market rocketed higher into 1983. Granville finally gave up and recommended buying when the Dow doubled in value. He continued to publish a market newsletter, a shadow of his former successful self.

A new guru entered the spotlight in 1984. Robert Prechter has made a name for himself as an Elliott Wave theorist. Elliott was an impecunious accountant who developed his market theory in the 1930s. He believed that the stock market rallied in 5 waves and fell in 3 waves, which in turn could be subdivided into lesser waves.

Like other market cycle gurus before him, Prechter had been writing an advisory letter for many years with modest success. When the bull market penetrated the 1000 level on the Dow, people began to pay

attention to the young analyst who kept calling for the Dow to reach 3000. The bull market went from strength to strength, and Prechter's fame grew by leaps and bounds.

In the roaring bull market of the 1980s, Prechter's fame swept outside the narrow world of investment newsletters and conferences. Prechter appeared on national television and was interviewed by popular magazines. In October 1987, he appeared to vacillate, first issuing a sell signal, then telling his followers to get ready to buy. As the Dow crashed 500 points, mass adulation of Prechter gave way to scorn and hatred. Some blamed him for the decline, others were angry that the market never reached his stated target of 3000. Prechter's advisory business shrank, and he largely retired from it.

All market cycle gurus have several traits in common. They become active in the forecasting business several years prior to reaching stardom. Each has a unique theory, a few followers, and some credibility, conferred by sheer survival in the advisory business. The fact that each guru's theory did not work for a number of years is ignored by his followers. When the theory becomes correct, the mass media take notice. When a theory stops working, mass adulation of a guru turns to hatred.

When you recognize that a successful new guru is emerging, it is profitable to jump on his bandwagon. It is even more important to recognize when a guru has reached his peak. All gurus crash—and by definition, they crash from the height of their fame. When a guru becomes accepted by the mass media, it is a sign that he has reached his crest. The mainstream media is wary of outsiders. When several mass magazines devote space to a hot market guru, you know that his end is near.

Another warning sign that a market guru has reached his peak occurs when he is interviewed by *Barron's*—America's largest business weekly. Every January, *Barron's* invites a panel of prominent analysts to dispense wisdom and issue forecasts for the year ahead. The panel is usually made up of "safe" analysts who focus on price/earnings ratios, emerging growth industries, and so on. It is highly atypical of *Barron's* to invite a hot guru with an offbeat theory to its January panel. A guru gets invited only when the public clamors for him, and to exclude him would diminish the prestige of the magazine. Both Granville and Prechter were invited to the January panel when each man was at the crest of his fame. Each guru fell within a few months of appearing on that panel. The next time a market guru is on *Barron's* January panel, do not renew your subscription to his newsletter.

Mass psychology being what it is, new gurus will certainly emerge. An old cycle guru never fully comes back. Once he stumbles, the adulation turns to derision and hatred. An expensive vase, once shattered, can never be fully restored.

Magic Method Gurus

Market cycle gurus are creatures of the stock market, but "method gurus" are more prominent in the derivative markets, especially in the futures markets. A "method guru" erupts on the financial scene after discovering a new analytic or trading method.

Traders always look for an edge, an advantage over fellow traders. Like knights shopping for swords, they are willing to pay handsomely for their trading tools. No price is too high if it lets them tap into a money pipeline.

A magic method guru sells a new set of keys to market profits. As soon as enough people become familiar with a new method and test it in the markets, it inevitably deteriorates and starts losing popularity. Markets are forever changing, and the methods that worked yesterday are not likely to work today and even less likely to work a year from now.

In the early 1970s, Chicago market letter writer Jake Bernstein became hot by using market cycles to call tops and bottoms. His methods worked well and his fame spread. Bernstein charged high fees for his newsletters, ran conferences, managed funds, and produced an endless flow of books. As usual, the markets changed, becoming less and less cyclical in the 1980s.

Peter Steidlmayer was another method guru whose star rose high above Chicago. He urged his followers to discard old trading methods in favor of his Market Profile. That method promised to reveal the secrets of supply and demand and give true believers an ability to buy at the bottoms and sell at the tops. Steidlmayer teamed up with entrepreneur Kevin Koy, and their frequent seminars attracted upward of 50 people who paid $1600 for a 4-day class. There appeared to be no conspicuous examples of success among Market Profile devotees, and the founders had a nasty falling out. Steidlmayer got a job with a brokerage firm, and both he and Koy continued to give occasional seminars.

Oddly enough, even in this era of fast global links, reputations change slowly. A guru whose image has been destroyed in his own country can make money peddling his theory overseas. That point has been made to

me by a guru who compared his continued popularity in Asia to what happens to faded American singers and movie stars. They are unable to attract an audience in the United States, but they can still make a living singing abroad.

Dead Gurus

The third type of a market guru is a dead guru. His books are reissued, his market courses are scrutinized by new generations of eager traders, and the legend of the dear-departed analyst's prowess and personal wealth grows posthumously. The dead guru is no longer among us and cannot capitalize on his fame. Other promoters profit from his reputation and from expired copyrights. One dear-departed guru is R. N. Elliott, but the best example of such a legend is W. D. Gann.

Various opportunists sell "Gann courses" and "Gann software." They claim that Gann was one of the best traders who ever lived, that he left a $50 million estate, and so on. I interviewed W. D. Gann's son, an analyst for a Boston bank. He told me that his famous father could not support his family by trading but earned his living by writing and selling instructional courses. When W. D. Gann died in the 1950s, his estate, including his house, was valued at slightly over $100,000. The legend of W. D. Gann, the giant of trading, is perpetuated by those who sell courses and other paraphernalia to gullible customers.

The Followers of Gurus

The personalities of market gurus differ. Some are dead, but those who are alive range from serious academic types to great showmen. A guru has to produce original research for several years, then get lucky when the market turns his way.

To read about the scandals that surrounded many gurus, try *Winner Takes All* by William Gallacher and *The Dow Jones Guide to Trading Systems* by Bruce Babcock. The purpose of this section is simply analysis of the guru phenomenon.

When we pay a guru, we expect to get back more than we spend. We act like a man who bets a few dollars against a three-card monte dealer

on a street corner. He hopes to win more than he put down on an overturned crate. Only the ignorant or greedy take the bait.

Some people turn to gurus in search of a strong leader. They look for a parent-like omniscient provider. As a friend once said, "They walk with their umbilical cords in hand, looking for a place to plug them in." A smart promoter provides such a receptacle, for a fee.

The public wants gurus, and new gurus will come. As an intelligent trader, you must realize that in the long run, no guru is going to make you rich. You have to work on that yourself.

7. SELF-DESTRUCTIVENESS

Trading is a very hard game. A trader who wants to be successful in the long run has to be very serious about what he does. He cannot afford to be naive or to trade because of some hidden psychological agenda.

Unfortunately, trading often appeals to impulsive people, to gamblers, and to those who feel that the world owes them a living. If you trade for the excitement, you are liable to take trades with bad odds and accept unnecessary risks. The markets are unforgiving, and emotional trading always results in losses.

Gambling

Gambling means betting on games of chance or skill. It exists in all societies, and most people have gambled at some point in their lives.

Freud believed that gambling was universally attractive because it was a substitute for masturbation. The repetitive and exciting activity of the hands, the irresistible urge, the resolutions to stop, the intoxicating quality of pleasure, and the feelings of guilt link gambling and masturbation.

Dr. Ralph Greenson, a prominent California psychoanalyst, has divided gamblers into three groups: the normal person who gambles for diversion and who can stop when he wishes; the professional gambler, who selects gambling as his means of earning a livelihood; and the neurotic gambler, who gambles because he is driven by unconscious needs and is unable to stop.

A neurotic gambler either feels lucky or wants to test his luck. Winning gives him a sense of power. He feels pleased, like a baby feeding at a

breast. A neurotic gambler always loses because he tries to re-create that omnipotent feeling of bliss instead of concentrating on a realistic long-term game plan.

Dr. Sheila Blume, director of the compulsive gambling program at South Oaks Hospital in New York, calls gambling "an addiction without a drug." Most gamblers are men who gamble for the action. Women tend to gamble as a means of escape. Losers usually hide their losses and try to look and act like winners, but they are plagued by self-doubt.

Trading stocks, futures, and options gives a gambler a high but it does appear more respectable than betting on the ponies. Moreover, gambling in the financial markets has an aura of sophistication and offers a better intellectual diversion than playing numbers with a bookie.

Gamblers feel happy when trades go in their favor. They feel terribly low when they lose. They differ from successful professionals who focus on long-term plans and do not get particularly upset or excited in the process of trading.

Brokers are well aware that many of their clients are gamblers. They often try to avoid leaving messages for traders with their wives, even when they call to confirm a trade. Amateurs are not the only ones involved in gambling—quite a bit of it goes on among professionals. Sonny Kleinfield describes in his book, *The Traders,* the endemic betting on sports events on the floors of financial exchanges.

The key sign of gambling is the inability to resist the urge to bet. If you feel that you are trading too much and the results are poor, stop trading for a month. This will give you a chance to re-evaluate your trading. If the urge to trade is so strong that you cannot stay away from the action for a month, then it is time to visit your local chapter of Gamblers Anonymous or start using the principles of Alcoholics Anonymous, outlined later in this chapter.

Self-Sabotage

After practicing psychiatry for many years, I became convinced that most failures in life are due to self-sabotage. We fail in our professional, personal, and business affairs not because of stupidity or incompetence, but to fulfill an unconscious wish to fail.

A brilliant and witty friend of mine has a lifelong history of demolishing his success. As a young man, he was a successful industrial salesman and was sacked; he entered training as a broker and rose near the

top of his firm but was sued; he became a well-known trader but busted out while disentangling himself from previous disasters. He blamed all his failures on envious bosses, incompetent regulators, and an unsupportive wife.

Finally, he hit bottom. He had no job and no money. He borrowed a quote terminal from another busted-out trader and raised capital from a few people who had heard that he had traded well in the past. He knew how to trade and made money for his pool. As the word spread, more people brought in money. My friend was on a roll. At that point, he went on a speaking tour of Asia but continued to trade from the road. He took a side trip into a country famous for its prostitutes, leaving a very large open position with no protective stop. By the time he returned to civilization, the markets had staged a major move and his pool was wiped out. Did he try to figure out his problem? Did he try to change? No—he blamed his broker!

It hurts to look within yourself for the cause of your failure. When traders get in trouble, they tend to blame others, bad luck, or anything else.

A prominent trader came to me for a consultation. His equity was being demolished by a rally in the U.S. dollar, in which he was heavily short. He had grown up fighting a nasty and arrogant father. He had made a name for himself by betting large positions on reversals of established trends. This trader kept adding to his short position because he could not admit that the market, which represented his father, was bigger and stronger than he was.

These are just two examples of how people act out self-destructive tendencies. We sabotage ourselves by acting like impulsive children rather than intelligent adults. We cling to our self-defeating patterns even though they can be treated—failure is a curable disease.

The mental baggage from childhood can prevent you from succeeding in the markets. You have to find your weaknesses in order to change. Keep a trading diary—write down your reasons for entering and exiting every trade. Look for repetitive patterns of success and failure.

The Demolition Derby

Almost every profession and business provides a safety net for its members. Your bosses, colleagues, and clients can warn you when you behave dangerously or self-destructively. There is no such support in trading,

which makes it more dangerous than most human endeavors. The markets offer many opportunities to self-destruct without a safety net.

All members of society make small allowances to protect one another from the consequences of our mistakes. When you drive, you try to avoid hitting other cars and they try to avoid hitting you. If someone swings open the door of a parked car, you swerve. If someone cuts in front of you on a highway, you may curse, but you will slow down. You avoid collisions because they are too costly for both parties.

Markets operate without normal human helpfulness. Every trader tries to hit others. Every trader gets hit by others. The trading highway is littered with wrecks. Trading is the most dangerous human endeavor, short of war.

Buying at the high point of the day is like swinging your car door open into the traffic. When your buy order reaches the floor, traders rush to sell to you—to rip your door off along with your arm. Other traders want you to fail because they get the money you lose.

Controlling Self-Destructiveness

Most people go through life making the same mistakes at sixty that they made at twenty. Others structure their lives to succeed in one area while acting out internal conflicts in another. Very few people grow out of their problems.

You need to be aware of your tendency to sabotage yourself. Stop blaming your losses on bad luck or on others and take responsibility for the results. Start keeping a diary—a record of all your trades, with reasons for entering and exiting them. Look for repetitive patterns of success and failure. Those who do not learn from the past are condemned to repeat it.

You need a psychological safety net the way mountain climbers need their survival gear. I found the principles of Alcoholics Anonymous, outlined later in this chapter, to be of great help. Strict money management rules also provide a safety net.

If you seek therapy for your trading problems, choose a competent therapist who knows what trading is about. You are ultimately responsible for your own therapy and must monitor its progress. I usually tell my patients that if a month goes by without clear signs of improvement, then therapy is in trouble. When therapy shows no progress for two months, it is time to seek a consultation with another therapist.

8. TRADING PSYCHOLOGY

Your feelings have an immediate impact on your account equity. You may have a brilliant trading system, but if you feel frightened, arrogant, or upset, your account is sure to suffer. When you recognize that a gambler's high or fear is clouding your mind, stop trading. Your success or failure as a trader depends on controlling your emotions.

When you trade, you compete against the sharpest minds in the world. The field on which you compete has been slanted to ensure your failure. If you allow your emotions to interfere with your trading, the battle is over.

You are responsible for every trade that you make. A trade begins when you decide to enter the market and ends only when you decide to take yourself out. Having a good trading system is not enough. Most traders with good systems wash out of the markets because psychologically they are not prepared to win.

Bending the Rules

Markets offer enormous temptations, like walking through a gold vault or through a harem. Markets evoke powerful greed for more gains and a great fear of losing what we've got. Those feelings cloud our perceptions of opportunities and dangers.

Most amateurs feel like geniuses after a winning streak. It is exciting to believe that you are so good you can bend your own rules and succeed. That's when traders deviate from their rules and go into a self-destruct mode.

Traders gain some knowledge, they win, their emotions kick in, and they self-destruct. Most traders promptly give their "killings" back to the markets. The markets are full of rags to riches to rags stories. The hallmark of a successful trader is his ability to accumulate equity.

You need to make trading as objective as possible. Keep a diary of all your trades with "before and after" charts, keep a spreadsheet listing all your trades, including commissions and slippage, and maintain very strict money management rules. You may have to devote as much energy to analyzing yourself as you do to analyzing the markets.

When I was learning how to trade, I read every book on trading psychology I could find. Many writers offered sensible advice. Some stressed discipline: "You cannot let the markets sway you. Do not make decisions

during trading hours. Plan a trade, and trade a plan." Others stressed flexibility: "Do not enter the market with any preconceived notions. Change your plans when markets change." Some experts suggested isolation—no business news, no *Wall Street Journal,* no listening to other traders, just you and the markets. Others advised being open-minded, keeping in touch with other traders and soaking up fresh ideas. Each piece of advice seemed to make sense but contradicted other equally sensible advice.

I kept reading, trading, and focusing on system development. I also continued to practice psychiatry. I never thought the two fields were connected—until I had a sudden insight. The idea that changed how I trade came from psychiatry.

The Insight That Changed My Trading

Like most psychiatrists, I always had some patients with alcohol problems. I also served as a consultant to a major drug rehabilitation program. It did not take me long to realize that alcoholics and addicts were more likely to recover in self-help groups than in classical psychiatric settings.

Psychotherapy, medications, and expensive hospitals and clinics can sober up a drunk but seldom succeed in keeping him sober. Most addicts quickly relapse. They have a much better chance to recover if they become active in Alcoholics Anonymous (AA) or other self-help groups.

Once I realized that AA members were likely to stay sober and rebuild their lives, I became a big fan of Alcoholics Anonymous. I began sending patients with drinking problems to AA and related groups, such as ACOA (Adult Children of Alcoholics). Now, if an alcoholic comes to me for treatment, I insist that he also go to AA. I tell him that to do otherwise would mean wasting our time and his money.

One night, many years ago, I stopped by a friend's office on the way to a party at our department of psychiatry. We had two hours before the party, and my friend, who was a recovering alcoholic, said: "Do you want to take in a movie or go to an AA meeting?" I had sent many patients to AA but had never been to a meeting, since I have never had a drinking problem. I jumped at a chance to attend an AA meeting—it was a new experience.

The meeting was held at a local YMCA. A dozen men and a few women sat on folding chairs in a plain room. The meeting lasted an hour. I was amazed by what I heard—these people seemed to talk about my trading!

They talked about alcohol, but as long as I substituted the word "loss" for "alcohol," most of what they said applied to me! My account equity was still swinging up and down in those days. I left that YMCA room knowing that I had to handle my losses the way AA handles alcoholism.

9. TRADING LESSONS FROM AA

Almost any drunk can stay sober for a few days. Soon, the urge to drink overwhelms him again and he returns to the bottle. He cannot resist his urge because he continues to feel and think like an alcoholic. Sobriety begins and ends inside a person's mind.

Alcoholics Anonymous (AA) has a system for changing the way people think and feel about drinking. AA members use a 12-step program for changing their minds. These 12 steps, described in the book *Twelve Steps and Twelve Traditions,* refer to 12 stages of personal growth. Recovering alcoholics attend meetings where they share their experiences with other recovering alcoholics, supporting each other in their sobriety. Any member can get a sponsor—another AA member whom he can call for support when he feels the urge to drink.

AA was founded in the 1930s by two alcoholics—a doctor and a traveling salesman. They began meeting and helping each other stay sober. They developed a system that worked so well, others began to join them. AA has only one goal—to help its members stay sober. It does no fund-raising, takes no political positions, and runs no promotional campaigns. AA keeps growing thanks only to word of mouth. It owes its success only to its effectiveness.

The 12-step program of AA is so effective that people with other problems now use it. There are 12-step groups for children of alcoholics, smokers, gamblers, and others. I have become convinced that traders can stop losing money in the markets if they apply the key principles of Alcoholics Anonymous to their trading.

Denial

A social drinker enjoys a cocktail or a glass of wine or beer but stops when he feels he's had enough. An alcoholic's chemistry is different. Once an alcoholic takes a drink, he feels an urge to drink more, until he gets drunk.

A drunk often says that he needs to cut down on alcohol, but he cannot admit that his drinking is out of control. Most drunks deny that they are alcoholics. Try telling an alcoholic relative, friend, or employee that his drinking is out of control and damaging his life and you will run into a wall of denial.

An alcoholic often says: "My boss fired me 'cause I was hung over and came in late. My wife took the kids and left 'cause she had no sense to begin with. My landlord is trying to kick me out of the apartment 'cause I'm a little behind on the rent. I'm gonna have to cut down on my drinking, and everything will be all right."

This man has lost his family and his job. He is about to lose the roof over his head. His life is spinning out of control—but he keeps saying that he can cut down on his drinking. This is denial!

Alcoholics deny their problems while their lives are falling apart. Most of them nurse the fantasy of being able to control their drinking. As long as an alcoholic believes that he can "control his drinking," he is headed downhill. Nothing will ever change, even if he gets a new job, a new wife, and a new landlord.

Alcoholics deny that alcohol controls their lives. When they talk of reducing drinking, they talk about managing the unmanageable. They are like a driver whose car spins out of control on a mountain road. When the car careens down a cliff, it is too late to promise to drive carefully. An alcoholic's life careens out of control while he denies he's an alcoholic.

There is a stark parallel between an alcoholic and a trader whose account is being demolished by losses. He keeps changing trading tactics, acting like an alcoholic who tries to solve his problem by switching from hard liquor to beer. A loser denies that he has lost control over his course in the market.

Rock Bottom

A drunk can begin his journey to recovery only after he admits that he is an alcoholic. He must see that alcohol controls his life and not the other way around. Most drunks cannot accept this painful truth. They can face it only after they hit rock bottom.

Some alcoholics hit rock bottom when they develop a life-threatening illness. Others hit rock bottom after being rejected by their family or losing a job. An alcoholic needs to sink to a point so low, so deep down in the gutter, so unbearably painful that it finally penetrates his denial.

The pain of hitting rock bottom feels intolerable. It makes an alcoholic see how deeply he has sunk. This pain penetrates his denial. He sees a stark and simple choice—either turn his life around or die. Only then is an alcoholic ready to begin his journey to recovery.

Profits make traders feel powerful and give them an emotional high. They try to get high again, put on reckless trades, and give back their profits. Most traders cannot stand the pain of a string of severe losses. They die as traders after hitting rock bottom and wash out of the markets. The few survivors realize that the main trouble is not with their methods, the trouble is with their thinking. They can change and become successful traders.

The First Step

An alcoholic who wants to recover has to go through twelve steps—twelve stages of personal growth. He needs to change how he thinks and feels, how he relates to himself and others. The first step of AA is the hardest.

The first step an alcoholic has to take is to admit that he is powerless over alcohol. He must admit that his life has become unmanageable, that alcohol is stronger than he is. Most alcoholics cannot take that step, drop out, and go on to destroy their lives.

If alcohol is stronger than you, then you can never touch it again, not a sip for as long as you live. You have to give up drinking forever. Most drunks do not want to give up that pleasure. They destroy their lives rather than take the first step of AA. Only the pain of hitting rock bottom can supply the motivation to take that first step.

One Day at a Time

You have probably seen bumper stickers on cars that say "One day at a time" or "Easy does it." Those are AA slogans, and people who drive those cars are probably recovering alcoholics.

Planning for life without alcohol can seem overwhelming. That's why AA encourages its members to live sober one day at a time.

The goal of every AA member is to stay sober today and go to bed sober tonight. Gradually, days become weeks, then months, then years. AA meetings and other activities help each recovering alcoholic stay sober, one day at a time.

Recovering alcoholics receive—and give others—invaluable support and fellowship at these meetings. They are held at all hours, all over the world. Traders have much to learn from those meetings.

An AA Meeting

One of the best things that a trader can do is go to an AA meeting. I especially recommend it to a trader on a losing streak. Call Alcoholics Anonymous and ask about the next "open meeting" or "beginners' meeting" in your area.

A meeting lasts about an hour. You can sit in the back of the room and listen carefully. There is no pressure to speak, and nobody asks for your last name.

Each meeting begins with a long-term member getting up and speaking about his or her personal struggle for recovery from alcoholism. Several other members share their experiences. There is a collection to cover expenses—most people give a dollar. All you have to do is listen carefully, and every time you hear the word "alcohol," substitute the word "loss" for it. You will feel as if the people in the meeting are talking about your trading!

10. LOSERS ANONYMOUS

A social drinker enjoys an occasional drink, but an alcoholic craves alcohol. He denies that alcohol controls and destroys his life—until he reaches a personal crisis. It may be a life-threatening illness, unemployment, desertion by a family member, or another unbearably painful event. AA calls it "hitting rock bottom."

The pain of hitting rock bottom punctures an alcoholic's denial. He sees a stark choice—to drown or to turn and swim up for air. His first step to recovery is to admit that he is powerless over alcohol. A recovering alcoholic can never drink again.

Loss is to a loser what alcohol is to an alcoholic. A small loss is like a single drink. A big loss is like a bender. A series of losses is like an alcoholic binge. A loser keeps switching between different markets, gurus, and trading systems. His equity shrinks while he is trying to re-create the pleasurable sensation of winning.

Losing traders think and act like alcoholics, except that their speech is not slurred. The two groups are so much alike that you can predict what a loser will do by using alcoholics as a model.

Alcoholism is a curable disease—and so is losing. Losers can change if they start using the principles of Alcoholics Anonymous.

The Urge to Trade

Successful traders treat drawdowns the way social drinkers treat alcohol. They have a little and stop. If they take several losses in a row, they take that as a signal that something is wrong: It is time to stop and rethink their analysis or methods. Losers cannot stop—they keep trading because they are addicted to the excitement of the game and keep hoping for a big win.

One prominent trading advisor wrote that the pleasure of trading was higher than that of sex or flying jet aircraft. Just as an alcoholic proceeds from social drinking to drunkenness, losers take bigger and bigger risks. They cross the line between taking a business risk and gambling. Many losers do not even know that line exists.

Losers feel the urge to trade, just as alcoholics feel the urge to drink. They make impulsive trades, go on trading binges, and try to trade their way out of a hole.

Losers bleed money from their accounts. Most of them bust out, but some turn to managing other people's money after they lose their own; still others sell advisory services, like burned-out drunks who wash glasses in a bar.

Most losers hide their losses from themselves and from everyone else. They keep shuffling money, keep poor records, and throw away brokerage slips. A loser is like an alcoholic who does not want to know how many ounces of liquor he drank.

Into the Hole

A loser never knows why he loses. If he knew, he would have done something about it and become a winner. He keeps trading in a fog. A loser tries to manage his trading the way an alcoholic tries to manage his drinking.

Losers try to trade their way out of a hole. They switch trading systems, buy new software, or take tips from a new guru. They act out a

rescue fantasy—a charming belief in Santa Claus. Their desperate belief in magic solutions helps many advisors sell their services to the public.

When losses mount and equity shrinks, a loser acts like an alcoholic threatened with an eviction or a firing. A loser grows desperate and converts outright positions into spreads, doubles up on losing positions, reverses and trades in the opposite direction, and so on. Losers get as much good from these maneuvers as an alcoholic who switches from hard liquor to wine.

A losing trader careens out of control, trying to manage the unmanageable. Alcoholics die prematurely, and most traders bust out of the markets and never come back. New trading methods, hot tips, and improved software cannot help you until you learn to handle yourself. You have to change how you think in order to stop losing and begin your recovery as a trader.

Losers get drunk on losses; they're addicted to losses. Traders prefer profits, but even losses provide plenty of excitement. The pleasure of trading is very high. Few losers are actively trying to lose—but then few alcoholics are consciously trying to end up in the gutter.

A loser keeps getting high from trading while his equity shrinks. Trying to tell him that he is a loser is like trying to take a bottle away from a drunk. A loser has to hit rock bottom before he can begin to recover.

Rock Bottom

Hitting rock bottom feels horrible. It is painful and humiliating. You hit it when you lose money you cannot afford to lose. You hit it when you gamble away your savings. You hit it after you tell your friends how smart you are and later have to ask them for a loan. You hit rock bottom when the market comes roaring at you and yells: "You fool!"

Some people hit rock bottom after only a few weeks of trading. Others keep adding money to their account to postpone the day of reckoning. It hurts to see a loser in the mirror.

We spend our lifetimes building up self-esteem. Most of us have a high opinion of ourselves. It hurts a smart and successful person to hit rock bottom. Your first impulse may be to hide, but remember you are not alone. Almost every trader has been there.

Most people who hit rock bottom die as traders. They slink away from the market and never look back. Brokerage records indicate that 90 out

of 100 people trading today will probably be gone from the markets a year from now. They will hit rock bottom, crumble, and leave. They will try to forget trading as they would a bad dream.

Some losers will lick their wounds and wait until the pain fades away. Then they will return to trading, having learned little. They will be fearful, and their fear will further impair their trading.

Very few traders will begin the process of change and growth. For these rare individuals, the pain of hitting rock bottom will interrupt the vicious cycle of getting high from winning and then losing everything and crashing. *When you admit that you have a personal problem that causes you to lose, you can begin building a new trading life. You can start developing the discipline of a winner.*

The First Step

An alcoholic needs to admit that he cannot control his drinking. A trader needs to admit that he cannot control his losses. He needs to admit that he has a psychological problem with the losses and that he is destroying his trading account. The first step of an AA member is to say: "I am an alcoholic, I am powerless over alcohol." As a trader, you have to take your first step and say: "I am a loser, I am powerless over losses."

A trader can recover using the principles of Alcoholics Anonymous. Recovering alcoholics struggle to stay sober, one day at a time. Now you have to struggle to trade without losses, one day at a time.

You may say this is impossible. What if you buy, and the market immediately ticks down? What if you sell short at the bottom tick, and the market rallies? Even the best traders lose money on some trades.

The answer is to draw a line between a businessman's risk and a loss. A trader must take a businessman's risk, but he may never take a loss greater than his predetermined risk.

A storekeeper takes a risk every time he stocks new merchandise. If it does not sell, he will lose money. An intelligent businessman takes only risks that will not put him out of business even if he makes several mistakes in a row. Stocking two crates of merchandise may be a sensible business risk, but stocking a full trailer is probably a gamble.

As a trader, you are in the business of trading. You need to define your businessman's risk—the maximum amount of money you will risk on any single trade. There is no standard dollar amount, just as there is no

standard business. An acceptable businessman's risk depends, first of all, on the size of your trading account. It also depends on your trading method and pain tolerance.

The concept of a businessman's risk will change the way you manage your money (see Chapter 10, "Risk Management"). A sensible trader never risks more than 2 percent of account equity on any trade. For example, if you have $30,000 in your account, you may not risk more than $600 per trade, and if you have $10,000, you may not risk more than $200. If your account is small, limit yourself to trading less expensive markets, or mini-contracts. If you see an attractive trade but your stop would have to be placed where more than 2 percent of equity would be at risk—pass that trade. Avoid risking more than 2 percent on a trade the way a recovering alcoholic avoids bars. If you are not sure how much to risk, err on the side of caution.

If you blame excess commissions on a broker and slippage on a floor trader, you give up control of your trading life. Try to reduce both, but take responsibility for them. If you lose even a dollar more than your businessman's risk, including commissions and slippage, you are a loser.

Do you keep good trading records? Poor record-keeping is a sure sign of a gambler and a loser. Good businessmen keep good records. Your trading records must show the date and price of every entry and exit, slippage, commissions, stops, all adjustments of stops, reasons for entering, objectives for exiting, maximum paper profit, maximum paper loss after a stop was hit, and any other necessary data.

If you bail out of a trade within your businessman's risk, it is normal business. There is no bargaining, no waiting for another tick, no hoping for a change. Losing a dollar more than your established businessman's risk is like getting drunk, getting into a brawl, getting sick to your stomach on your way home, and waking up in the gutter with a headache. You would never want that to happen.

A Meeting for One

When you go to an AA meeting, you will see people who have not had a drink in years stand up and say: "Hello, my name is so-and-so, and I am an alcoholic." Why do they call themselves alcoholics after years of sobriety? Because if they think they have beaten alcoholism, they will start drinking again. If a person stops thinking he is an alcoholic, he is

free to take a drink, then another, and will probably end up in the gutter again. A person who wants to stay sober must remember that he is an alcoholic for the rest of his life.

Traders would benefit from our own self-help organization—I'd call it Losers Anonymous. Why not Traders Anonymous? Because a harsh name helps to focus attention on our self-destructive tendencies. After all, Alcoholics Anonymous do not call themselves Drinkers Anonymous. As long as you call yourself a loser, you focus on avoiding losses.

Several traders have argued against what they thought was the "negative thinking" of Losers Anonymous. A retired woman from Texas, a highly successful trader, described her approach to me. She is very religious and thinks it would not please the Lord for her to lose money. She cuts her losses very fast because of that. I thought that our methods were similar. The goal is to cut losses due to some objective, external rule.

Trading within a businessman's risk is like living without alcohol. A trader has to admit that he is a loser, just as a drunk has to admit that he is an alcoholic. Then he can begin his journey to recovery.

This is why every morning before trading I sit in front of the quote screen in my office and say: "Good morning, my name is Alex, and I am a loser. I have it in me to do serious financial damage to my account." This is like an AA meeting—it keeps my mind focused on the first principles. Even if I take thousands of dollars out of the market today, tomorrow I will say: "Good morning, my name is Alex and I am a loser."

A friend of mine joked: "When I sit in front of my quote machine in the morning, I say, 'My name is John, and I'm gonna rip your throat out.' " His thinking generates tension. "Losers Anonymous" thinking generates serenity. A trader who feels serene and relaxed can focus on looking for the best and safest trades. A trader who is tense is like a driver who freezes at the wheel. When a sober man and a drunk enter a race, you know who is more likely to win. A drunk may win once in a while thanks to luck, but the sober man is the one to bet on. You want to be the sober man in the race.

11. WINNERS AND LOSERS

We come to the market from different walks of life and bring with us the mental baggage of our upbringing and prior experiences. Most of us find that when we act in the market the way we do in our everyday life, we lose money.

Your success or failure in the market depends on your thoughts and feelings. It depends on your attitudes toward gain and risk, fear and greed, and on how you handle the excitement of trading and risk.

Most of all, your success or failure depends on your ability to use your intellect rather than act out your emotions. A trader who feels overjoyed when he wins and depressed when he loses cannot accumulate equity because he is controlled by his emotions. If you let the market make you feel high or low, you will lose money.

To be a winner in the market you must know yourself and act coolly and responsibly. The pain of losing scares people into looking for magic methods. At the same time, they discard much of what is useful in their professional or business backgrounds.

Like an Ocean

The market is like an ocean—it moves up and down regardless of what you want. You may feel joy when you buy a stock and it explodes in a rally. You may feel drenched with fear when you go short but the market rises and your equity melts with every uptick. These feelings have nothing to do with the market—they exist only inside you.

The market does not know you exist. You can do nothing to influence it. You can only control your behavior.

The ocean does not care about your welfare, but it has no wish to hurt you either. You may feel joy on a sunny day, when a gentle wind pushes your sailboat where you want it to go. You may feel panic on a stormy day when the ocean pushes your boat toward the rocks. Your feelings about the ocean exist only in your mind. They threaten your survival when you let your feelings rather than intellect control your behavior.

A sailor cannot control the ocean, but he can control himself. He studies currents and weather patterns. He learns safe sailing techniques and gains experience. He knows when to sail and when to stay in the harbor. A successful sailor uses his intelligence.

An ocean can be useful—you can fish in it and use its surface to get to other islands. An ocean can be dangerous—you can drown in it. The more rational your approach, the more likely you are to get what you want. When you act out your emotions, you cannot focus on the reality of the ocean.

A trader has to study trends and reversals in the market the way a

sailor studies the ocean. He must trade on a small scale while learning to handle himself in the market. You can never control the market but you can learn to control yourself.

A beginner who has a string of profitable trades often feels he can walk on water. He starts taking wild risks and blows up his account. On the other hand, an amateur who takes several losses in a row often feels so demoralized that he cannot place an order even when his system gives him a strong signal to buy or sell. If trading makes you feel elated or frightened, you cannot fully use your intellect. When joy sweeps you off your feet, you will make irrational trades and lose. When fear grips you, you'll miss profitable trades.

A professional trader uses his head and stays calm. Only amateurs become excited or depressed because of their trades. Emotional reactions are a luxury that you cannot afford in the markets.

Emotional Trading

Most people crave excitement and entertainment. Singers, actors, and professional athletes command much higher incomes in our society than do such mundane workmen as physicians, pilots, or college professors. People love to have their nerves tickled—they buy lottery tickets, fly to Las Vegas, and slow down to gawk at road accidents.

Trading is a heady experience and can be very addictive. Losers who drop money in the markets receive a tremendous entertainment value.

The market is among the most entertaining places on the face of the Earth. It is a spectator sport and a participant sport rolled into one. Imagine going to a major-league ball game in which you are not confined to the bleachers. For a few hundred dollars you can run onto the field and join the game. If you hit the ball right, you will get paid like a professional.

You would probably think twice before running onto the field the first few times. This cautious attitude is responsible for the well-known "beginner's luck." Once a beginner hits the ball well a few times and collects his pay, he is likely to get the idea that he is better than the pros and could make a good living at it. Greedy amateurs start running out onto the field too often, even when there are no good playing opportunities. Before they know what hit them, a short string of losses destroys their careers.

Emotional decisions are lethal in the markets. You can see a good model of emotional trading by going to a racetrack, turning around, and watching the humans instead of the horses. Gamblers stomp their feet, jump up and down, and yell at horses and jockeys. Thousands of people act out their emotions. Winners embrace and losers tear up their tickets in disgust. The joy, the pain, and the intensity of wishful thinking are caricatures of what happens in the markets. A cool handicapper who tries to make a living at the track does not get excited, yell, or bet the bulk of his roll on any race.

Casinos love drunk patrons. They pour gamblers free drinks because drunks are more emotional and gamble more. Casinos try to throw out intelligent card-counters. There is less free liquor on Wall Street than in a casino, but at least here they do not throw you out of the game for being a good trader.

In Charge of Your Life

When a monkey hurts its foot on a tree stump, he flies into a rage and kicks the piece of wood. You laugh at a monkey, but do you laugh at yourself when you act like him? If the market drops while you are long, you may double up on your losing trade or else go short, trying to get even. You act emotionally instead of using your intellect. What is the difference between a trader trying to get back at the market and a monkey kicking a tree stump? Acting out of anger, fear, or elation destroys your chance of success. You have to analyze your behavior in the market instead of acting out your feelings.

We get angry at the market, we become afraid of it, we develop silly superstitions. All the while, the market keeps cycling through its rallies and declines like an ocean going through its storms and calm periods. Mark Douglas writes in *The Disciplined Trader* that in the market, "There is no beginning, middle, or end—only what you create in your own mind. Rarely do any of us grow up learning to operate in an arena that allows for complete freedom of creative expression, with no external structure to restrict it in any way."

We try to cajole or manipulate the market, acting like the ancient emperor Xerxes, who ordered his soldiers to horsewhip the sea for sinking his fleet. Most of us are not aware how manipulative we are, how we bargain, how we act out our feelings in the market. Most of us consider

ourselves the center of the universe and expect every person or group to be either good or bad to us. This does not work in the market which is completely impersonal.

Leston Havens, a Harvard University psychiatrist, writes: "Cannibalism and slavery are probably the oldest manifestations of human predation and submission. Although both are now discouraged, their continued existence in psychological forms demonstrates that civilization has achieved great success in moving from the concrete and physical to the abstract and psychological, while persisting in the same purposes." Parents threaten their children, bullies hit them, teachers try to bend their will in school. Little wonder that most of us grow up either hiding in a shell or learning how to manipulate others in self-defense. Acting independently does not feel natural to us—but that is the only way to succeed in the market.

Douglas warns, "If the market's behavior seems mysterious to you, it's because your own behavior is mysterious and unmanageable. You can't really determine what the market is likely to do next when you don't even know what you'll do next." Ultimately, "the one thing you can control is yourself. As a trader, you have the power either to give yourself money or to give your money to other traders." He adds, "The traders who can make money consistently . . . approach trading from the perspective of a mental discipline."

Each trader has his own demons to exorcise on the journey to becoming a successful professional. Here are several rules that worked for me as I grew from a wild amateur into an erratic semiprofessional and finally into a professional trader. You may change this list to suit your personality.

1. Decide that you are in the market for the long haul—that is, you want to be a trader even 20 years from now.

2. Learn as much as you can. Read and listen to experts, but keep a degree of healthy skepticism about everything. Ask questions, and do not accept experts at their word.

3. Do not get greedy and rush to trade—take your time to learn. The markets will be there with more good opportunities in the months and years ahead.

4. Develop a method for analyzing the market—that is, "If A happens, then B is likely to happen." Markets have many dimensions—use several analytic methods to confirm trades. Test everything on

historical data and then in the markets, using real money. Markets keep changing—you need different tools for trading bull and bear markets and transitional periods as well as a method for telling the difference (see the sections on technical analysis).

5. Develop a money management plan. Your first goal must be long-term survival; your second goal, a steady growth of capital; and your third goal, making high profits. Most traders put the third goal first and are unaware that goals 1 and 2 exist (see Chapter 10, "Risk Management").
6. Be aware that a trader is the weakest link in any trading system. Go to a meeting of Alcoholics Anonymous to learn how to avoid losses or develop your own method for cutting out impulsive trades.
7. Winners think, feel, and act differently than losers. You must look within yourself, strip away your illusions, and change your old ways of being, thinking, and acting. Change is hard, but if you want to be a professional trader, you have to work on changing your personality.